

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

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FISCAL IMPACT STATEMENT

LS 7858

BILL NUMBER: HB 1716

DATE PREPARED: Jan 8, 2001

BILL AMENDED:

SUBJECT: Inheritance Tax Deductions.

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FUNDS AFFECTED: X GENERAL
DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides that an individual receiving property subject to the Inheritance Tax may deduct from the total fair market value of the property interests received by the individual under one or more taxable transfers an amount equal to that part of the property subject to the Inheritance Tax that the individual subsequently contributes to a charitable organization. The bill specifies the manner in which the deduction must be claimed. The bill also prohibits an individual from claiming such a deduction if the charitable contribution was claimed on the individual's federal Income Tax return for the taxable year.

Effective Date: July 1, 2001.

Explanation of State Expenditures: The bill could potentially result in reductions in the amount of resident Inheritance Tax revenue retained by the counties. The revenue loss to counties is estimated to be \$325,445 statewide. As a result of the revenue loss, the bill could potentially increase expenditures from the state General Fund relating to the Inheritance Tax replacement for counties. The impact on the state General Fund may not equal the revenue loss to the counties since most are retaining more revenue than is guaranteed under the replacement procedure. The net impact of the bill reflected in the table below assumes that the revenue loss to the counties will be fully reimbursed by the state. In addition, since the Inheritance Tax does not have to be paid until a maximum of 18 months after the decedent's death (within 12 months of the date of death to receive the 5% early payment discount), the impact that the bill may have on county replacement would be somewhat delayed.

Explanation of State Revenues: The bill could potentially lead to a reduction in revenue from the Inheritance Tax and an increase in revenue from the Estate Tax. The bill is estimated to reduce Inheritance Tax revenue by approximately \$3.77 M in FY 2003. The bill is also estimated to increase Estate Tax revenue by approximately \$1.63 M in FY 2003. The net impact of the bill on state revenue is estimated to be a loss of \$2.14 M beginning in FY 2003. Further, the impact of state expenditures on county replacement increases the loss to the state (net revenue loss plus county replacement expenditures) to approximately \$2.47 M in

FY 2003 (See table below.).

It is important to note some very important caveats which, when considered, suggest that this analysis probably over-estimates the fiscal impact of the bill. First, due to database limitations, the estimate was performed such that 100% of the transferees in the sample database were assumed to take the deduction. Survey results referenced below suggest that the percentage making charitable contributions would be about 72%. Second, the estimates assume that all transferees will take the Inheritance Tax deduction and forego taking a deduction for the contribution against the federal Income Tax. This is problematic for two reasons. Since the federal deduction for charitable contributions is an itemized deduction it is not accessed by all federal filers. However, for those federal filers that are able to access the deduction, they would be more likely to take it as their income increases because it would provide a greater tax savings than would the Inheritance Tax deduction.

STATE IMPACT	FY 2003
Inheritance Tax Revenues	(\$ 3,769,225)
Estate Tax Revenues	\$1,633,976
Less: State Expenditures for County Replacement	(\$335,445)
Net Increase (Decrease)	(\$2,470,694)

Background: The bill would allow a transferee who receives a property interest transfer from a decedent to deduct from the total fair market value of the transfer for purposes of the Inheritance Tax any part of the transfer that they contribute to a charitable organization, provided that contribution is not deducted for purposes of federal Income Tax.

The estimated impact of the charitable contribution deduction is based, in part, on findings from the Giving and Volunteering National Survey conducted by *The Independent Sector*. The survey was conducted biennially from 1987 to 1995 and most recently in 1999. The surveys provide an estimate of the percentage of households in the United States that make contributions to charity, the average contribution amount, and the percentage of household income that this contribution, on average, represents. Considering all six of the surveys, the average percentage of households contributing to charity is estimated to be approximately 72%, and the percentage of household income contributed has been, on average, approximately 2.2%.

The estimated impact of the charitable contribution deduction is also based on an Office of Fiscal and Management Analysis (OFMA) database consisting of Inheritance Tax returns relating to decedents who died between July 1, 1997, and June 30, 2000. The database consists of 112,951 transferee records. It is assumed that the sample is representative of the universe of persons paying the Inheritance Tax. Of the total tax liability for the sample, 39.43% is attributable to Class A transferees, 35.35% is attributable to Class B transferees, and 25.22% is attributable to Class C transferees. The estimates are based on 100% of the sample transferees contributing a portion of their transfer to charity equal to 2.2% of the total fair market value of their transfer. This method assumes individual transferees behave the same as households (the unit of measurement in the surveys) and that individuals would view income and inheritance the same. It also assumes that transferees would prefer the Inheritance Tax deduction to the charitable contribution deduction under the federal Income Tax. This latter assumption is problematic. Taxpayers who can access the federal itemized deduction for charitable contributions would likely opt to utilize that deduction rather than the

Inheritance Tax deduction as their income increases. According to the sample database, the Inheritance Tax as a percentage of gross transfer value is 2.23% for Class A transferees; 8.19% for Class B transferees; and 11.7% for Class C transferees. Federal Internal Revenue Service statistics for 1998 indicate that the federal income tax as a percentage of adjusted gross income exceeds 2.23% for all income ranges above \$1,000; exceeds 8.19% for all income ranges above \$25,000; and exceeds 11.7% for all income ranges above \$75,000.

The estimated revenue loss is based on the Revenue Technical Committee's FY 2003 forecast for the Inheritance Tax equal to \$150 M. This total includes revenue from the Estate Tax estimated to be approximately 15% based on FY 2000 collections. This suggests that Inheritance Tax revenue is forecast at \$127.5 M. The estimated tax liability attributable to the different transferee classes is as follows: Class A transferees, \$50.28 M; Class B transferees, \$45.07 M; and Class C transferees, 32.16 M. The Inheritance Tax deduction reduced the sample Class A tax liability by 3.69%, the sample Class B tax liability by 2.49%, and the sample Class C tax liability by 2.45%. Applying these percentage reductions to the estimated FY 2003 tax collections from each class, the revenue loss is estimated to be approximately \$3.77 M.

Background on Estate Tax: Although the bill does not make changes to the Indiana Estate Tax, the reduction in Inheritance Tax liabilities for transferees could potentially have an impact on Indiana Estate Tax revenues. Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the federal state death tax credit (against the federal Estate Tax) exceeds the total Inheritance Tax paid by transferees of the estate. Consequently, for some estates a reduction in the Inheritance Tax liability paid by transferees of the estate results in a compensating increase in the Estate Tax liability.

The estimated impact of the bill on Estate Tax revenues is based on an OFMA database of Estate Tax returns relating to decedents who died between July 1, 1997, and June 30, 2000. The database consists of 559 estates upon which Indiana Estate Tax was paid. It is assumed that the sample is representative of the universe of estates paying the Indiana Estate Tax. The Inheritance Tax changes provided for in the bill led to a 7.26% increase in the Estate Tax liability of the sample. Based on the FY 2003 revenue forecast and FY 2000 collections, Estate Tax revenue is estimated to be \$22.5 M. As a result, the revenue gain from the bill is estimated to be approximately \$1.63 M.

Explanation of Local Expenditures:

Explanation of Local Revenues: Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. The revenue loss to counties is estimated to be approximately \$325,445 statewide. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. Therefore, a reduction in tax retained by a county due to the bill would be reimbursed only to the extent that the changes made by the bill cause the amount of tax revenue retained by the county to fall below its guaranteed amount. Currently, most counties are retaining more Inheritance Tax revenue than is guaranteed under the replacement procedure.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: State Revenue Forecast, December 19, 2000.
OFMA Inheritance and Estate Tax Databases.
National Survey of Giving and Volunteering: 1987-1998, *The Independent Sector*.
1998 Individual Income Tax Return Statistics, U. S. Internal Revenue Service.